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No. 87-1160

In The Supreme Court of the United States

OCTOBER TERM, 1987

DUQUESNE LIGHT COMPANY
AND
PENNSYLVANIA POWER COMPANY
Appellants,

v.

DAVID M. BARASCH,
CONSUMER ADVOCATE, et. al.
Appellees.

On Appeal from the Supreme Court of Pennsylvania

REPLY BRIEF FOR APPELLANTS

ALAN L. REED
WILLIAM E. ZEITER*
PETER BUSCEMI
JOHN F. STILLMUN, III

MORGAN, LEWIS & BOCKIUS
2000 One Logan Square
Philadelphia, PA 19103
(215) 963-5367

CHRISTINE A. HANSEN
RICHARD S. CHRISTNER
LARRY R. CRAYNE
DUQUESNE LIGHT COMPANY
1 Oxford Centre
301 Grant Street
Pittsburgh, PA 15279

JAMES R. EDGERLY
STEPHEN L. FELD
PENNSYLVANIA POWER COMPANY
1 East Washington Street
New Castle, PA 16103-0891

Attorneys for Duquesne Light Company and Pennsylvania Power Company

August 12, 1988

*Counsel of Record

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In this Reply Brief, the briefs of Appellees and supporting amici will be abbreviated as follows:

1. Brief for Appellee David M. Barasch, Consumer Advocate ("Brief for Consumer Advocate");

2. Brief for Appellee Pennsylvania Public Utility Commission ("Brief for PUC");

3. Brief for Consumer Federation of America, et al. ("Brief for CFA, et al.");

4. Brief of Industrial Energy Consumers of Pennsylvania, et al. ("Brief for IECPA");

5. Brief for the National Association of Regulatory Utility Commissioners ("Brief for NARUC");

6. Brief for the National Association of State Utility Consumer Advocates ("Brief for NASUCA");

7. Brief of the National Governors' Association, et al. ("Brief for National Governors' Assoc.").

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REPLY BRIEF FOR APPELLANTS

The briefs filed by Appellees and supporting amici obscure the critical way in which this case differs from prior utility rate cases in this Court. The controversy in those cases concerned such questions as how to measure the value of a utility's rate base, what items should be included in or excluded from the rate base, and how to calculate the return that a utility is entitled to earn on its rate base. In short, the cases to date have largely dealt with determining the constitutionally minimum return *on* a utility's investment that must be earned to compensate the utility's investors for the use of their investment dedicated to public use.

This case is different. Pennsylvania has told two of its utilities that they are not only barred from earning a

profit *on* their investment, but that they are also barred from recovering any of the out-of-pocket investment itself, an investment that, according to the PUC's own uncontested finding, was prudently incurred in fulfillment of the utility's statutory duty to provide electric service.

At all times relevant to this lawsuit, Duquesne and Penn Power operated under a statutory obligation to provide a reliable supply of electricity to their customers. That is not disputed. It is also not disputed that the utilities acted at all times in a perfectly reasonable and prudent manner in carrying out this obligation. They were prudent in deciding to add additional electric generating capacity. They were prudent in deciding that the capacity should be nuclear, since at the time nuclear power was projected as the least expensive alternative available to meet the burgeoning demand for electricity. They were prudent in cancelling the units when the demand for electricity unforeseeably collapsed. After encouraging the utilities to build additional capacity, and after the utilities had invested with the reasonable expectation that they would recover, at least, their prudent investment, Pennsylvania changed the rules to deny them any compensation, solely because their investment, when viewed with the benefit of perfect hindsight, was not deemed to be a success. This "end result," which requires the utilities to forfeit $50 million of money actually spent, is unfair and confiscatory.[1]

[1]The difference between the $50 million figure used by Appellants and the $44 million figure used by Appellees is a function of whether the Penn Power costs are stated in before-tax or after-tax dollars. Appellants have used the before-tax figure of $15,609,628, *see* Brief for Appellants at 7, n.9, and Appellees have used the after-tax figure of $9,569,665. *See* Brief for Consumer Advocate at 4. Both sides have used the Duquesne before-tax figure of $34,697,389.

Duquesne and Penn Power are constitutionally entitled to be "made whole," *FPC v. Hope Natural Gas Co.*, 320 U.S. 592, 606 (1944), for their prudent investment dedicated to public use. When a state places its utilities under a statutory obligation to serve, and the utilities prudently spend money for facilities intended to provide such service, under a regulatory scheme in which recovery of prudently incurred expenses is the rule, the utilities are at least entitled to get their money back.

This standard does not seek to render the utilities' investments "risk free." *See* Brief for PUC at 41-45; Brief for NARUC at 19; Brief for CFA, et al., at 63; Brief for IECPA, et al., at 17. As of today, the utilities have spent $50 million and have received nothing—no return *of* or *on* their money. Even if the utilities were today to receive $50 million, they would have earned no profit on their investment, and they would have lost the time value of their money. If the utilities prevail on this appeal and recover their $50 million through amortization over the next ten years, the real economic loss in terms of the time value of money will be even greater. Appellants' position in fact entails considerable risk even for undisputedly prudent investments, to say nothing of the even *greater* risk utilities must bear that their investments may be found to be imprudent or not properly directed toward fulfillment of the statutory obligation to provide electric service. It is simply false, therefore, to contend that Appellants' position would eliminate all investment risk.

Notwithstanding Pennsylvania's complete denial of any recovery of Appellants' $50 million investment, Appellees and supporting amici contend that Appellants somehow do not meet an alleged "threshold" test for constitutionally cognizable injury. Brief for Consumer

Advocate at 10. *See also* Brief for PUC at 34-36; Brief for National Governors' Assoc., et al., at 15-16; Brief for NARUC at 21-22; Brief for IECPA, et al., at 20. Simply put, Appellees argue that, because Appellants are substantial corporations, a deprivation of $50 million really does not matter enough to raise any constitutional concern. This argument has no merit. The alleged "threshold" test is arbitrary and unsupported. It would unjustifiably make findings of constitutional violations turn on the size of the victim.

Appellees also attempt to deny that the decision of the Pennsylvania Supreme Court is the least bit unusual or unexpected in the context of the State's regulation of utility rates. Relying on the so-called "used and useful" standard, Appellees maintain that rate orders denying any recovery of prudent investment are commonplace in the regulatory scheme. Brief for Consumer Advocate at 19-26; Brief for PUC at 23-27; Brief for National Governors' Assoc., et al., at 12-24; Brief for NASUCA at 12-27; Brief for IECPA, et al., at 19-25. This argument also has no merit. As historically used in utility rate regulation, and indeed as Appellee PUC argued below,[2] the "used and useful" standard has concerned what items should and should not be included in a utility's rate base and thus what return a utility should be permitted to earn *on* its investment. Contrary to appellees' assertion, the "used and useful" test has not ordinarily been used to limit utilities' recovery *of* prudently incurred expenses.

In the paragraphs that follow, each of these points is addressed in greater detail.

[2] *See* notes 6 & 11 *infra*.

1. This Court's decision in *Hope* does not preclude effective judicial review of Act 335 and the rate orders at issue. Appellees and supporting amici have seized upon *Hope*'s references to the "total effect" of a rate order as justification for their proposed "threshold" test. Appellees also appear to rely on *Hope* as authority for a kind of *per se* rule precluding all challenges to ratemaking methodologies, no matter how unfair, illogical, or manipulative, and focusing exclusively on the ratemaking authority's "end result." *See* Brief for Consumer Advocate at 14-19. Neither of these approaches makes any sense, and neither is supported by *Hope*, *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), or other decisions of this Court.

a. The proposed "threshold" test. The "threshold" test that Appellees and supporting amici read into *Hope* allegedly requires that, before any constitutional attack can be levelled, a rate order must have a financial impact that can be called "confiscatory." Significantly, however, there is no attempt to suggest a working definition of what "impact" would be sufficient to satisfy this test. Appellees' approach of comparing the amount of the investment at issue with the totality of the utilities' investment misses the mark. The "total effect" of the Pennsylvania Supreme Court's decision is that the investors of Duquesne and Penn Power once had $50 million and will never see that money again.

In *Hope*, the Court found that rates were not confiscatory because the rate order at issue permitted the utility to obtain a return *of*, and to earn a fair return *on*, its prudent investment, not because of the absence of some unspecified financial impact. The financial impact of a rate order on a utility is one of the "pertinent factors,"

Permian, 390 U.S. at 372, to be considered in balancing investor and consumer interests, and may sometimes be dispositive in demonstrating the unfairness of a particular rate order. However, financial impact in and of itself is not a determinative "threshold" for standing to advance a Fifth Amendment claim of confiscatory rates, particularly where the utility's return *of* its investment is at issue.

Applying such a threshold standard, moreover, is inherently arbitrary. For example, assuming that Duquesne is a large utility and Penn Power is small, or assuming Penn Power is in sound financial health and Duquesne is on the brink of bankruptcy, a rate order that treats the utilities in exactly the same manner might pass a "threshold" test of financial impact as to one utility and not the other. It would be an unjust rule of law in the context of the Fifth Amendment that sanctions a taking from large or financially sound utilities, yet compensates small or financially poor ones.

b. The alleged immunization of ratemaking methodologies. *Hope*'s reference to the "end result" of utility rate orders (320 U.S. at 603) does not, and was never intended to, bar this Court from scrutinizing, and in appropriate circumstances invalidating, particular ratemaking methodologies. In *Hope*, this Court was faced with the contention that the Fifth Amendment limited Congress to regulating natural gas rates according to a single method, the fair value approach of *Smyth v. Ames*, 169 U.S. 466 (1898). The Court held that the Federal Power Commission's use of the prudent investment method was contemplated by Congress and permissible under the Fifth Amendment. References in *Hope* and its

progeny[3] to the principle that only the "end result" may be considered in analyzing claims of confiscation must be recognized for what they are: a shorthand for the ultimate conclusion that there is no single ratemaking methodology, procedural or substantive, that the Fifth Amendment imposes on ratemakers. Such language was never intended to insulate all ratemaking methodologies, no matter how arbitrary, unfair, or irrational, from constitutional challenge.

Surely if the PUC set rates by selecting figures from a random number table or by having a monkey throw darts against a chart of numbers on a wall, those methods would not be sustained solely because the number selected was a permissible "end result." A broken clock is guaranteed to be right twice a day, but that does not make it an acceptable device for telling time.

Where a state applies inconsistent ratemaking standards that combine inevitably to prevent a utility from recovering its cost of doing business—as Pennsylvania has done in this case—that method is confiscatory. *West Ohio Gas Co. v. Public Utilities Comm'n*, 294 U.S. 63 (1935) (the mixing of distinct methods to guarantee a shortfall is *per se* unconstitutional). *See also Farmers Union Central Exchange Inc. v. FERC*, 734 F.2d 1486, 1527 (D.C. Cir.), *cert. denied*, 469 U.S. 1034 (1984) (combination of inconsistent ratemaking methodologies does not produce an acceptable "end result"); *American Telephone & Telegraph Co. v. FCC*, 836 F.2d 1386, 1390 (D.C. Cir. 1988) (same).

[3] *See, e.g., FCC v. Florida Power Corp.*, 480 U.S. 245 (1987), *FERC v. Pennzoil Producing Co.*, 439 U.S. 508, 519 (1979); *FPC v. Conway Corp.*, 426 U.S. 271, 278 (1976); *FPC v. Texaco, Inc.*, 417 U.S. 380, 391-92 (1974); *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 316 (1974); *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251 (1951); *Market Street Railway Co. v. Railroad Comm'n*, 324 U.S. 548 (1945).

Pennsylvania's methodology is unacceptable because it requires the PUC to shift between prudent investment and market value regulatory methods as needed to produce the lowest possible rate. If utility operations have successfully matched available electrical generating capacity and actual consumer demand for electricity, whether due to beneficial circumstances or to efficient utility management, Pennsylvania applies the prudent investment methodology. Under this approach, investors in the utility are restricted to a return *of* and a modest return *on* the historical value of their original investment. On the other hand, if utility management prudently expends funds to prepare for reasonably anticipated future growth, but that growth does not materialize, Act 335 is applied. Suddenly, the State looks not to the amount of the original prudent investment but rather to the market value of the items or services purchased. Regardless of how prudent an investment may have been when made, it is conclusively presumed to have no value and on that basis the statute bars the utility from retrieving any part of its investment.

Pennsylvania's ratemaking methodology divorces the standard for recovery from the decisions that govern the utility's expenditures. Because not even the most prudent manager possesses perfect foresight, Pennsylvania's mixing of ratemaking formulas guarantees that the utility will inevitably suffer losses that it cannot avoid.[4] Given the statutory duty to serve, a utility can-

[4]In the long run, this mixing of formulas necessarily will consume much of the capital invested in the business, as the inevitable losses from unforseeable detrimental conditions will not be restored by the gains from unforseeable beneficial conditions or from efficient utility management. This unrecovered long term consumption of investment is unfair and confiscatory. *See AT & T*, 836 F.2d at 1390-91.

not choose to avoid taking steps to expand its generating capacity in the face of consensus projections of higher electricity demand. Yet if that expansion turns out in retrospect not to have been needed because of changes in conditions that no one could have foreseen, the utility is penalized for doing something it had no choice but to do. A method that produces this "end result" is inherently unfair and confiscatory.

2. The "used and useful" standard does not bar recovery of prudently incurred expenses. Appellees and supporting amici argue that Pennsylvania's established application of the "used and useful" standard precludes recovery of the disputed costs and thus negates the reasonableness of any expectation that Appellants would recover their prudent out-of-pocket expenses even if the CAPCO units were not completed. Brief for Consumer Advocate at 19-26; Brief for PUC at 21-23; Brief for NASUCA at 12-27; Brief for CFA, et al., at 41-46. Appellees have erroneously sought to borrow a concept developed in another regulatory context and apply it here.

Historically, the "used and useful" standard has been employed as a limitation on the items that can properly be included in a utility's rate base. The standard has been applied, in other words, to limit the investment *on* which a utility could expect to earn a return. Before the Pennsylvania Supreme Court's interpretation of Act 335, the "used and useful" test was not applied to deny utilities a recovery *of* their prudently incurred expenses. Rather, Pennsylvania permitted its utilities to amortize their out-of-pocket costs for facilities that were rendered not "used and useful" by unforeseeable circumstances. *See, e.g., Pennsylvania Public Utility Comm'n v. Philadelphia Electric Co.*, 46 Pa. P.U.C. 746, 750 (1973) (10-year amortization of unusual expenses caused by tropical storm); *Pennsylvania Public Utility Comm'n v. UGI Corp.*-

Luzerne Electric Div., 47 Pa. P.U.C. 611, 634-35 (1974) (same); *Howes v. Mather Water Co.*, 13 P.U.R. 3d 486, 490 (1956) (14-year amortization of losses due to abandonment of contaminated water supply).[5]

For confirmation of this point, the Court need look no further than the PUC itself. The PUC's brief before the Pennsylvania Supreme Court in this very case removes all question about what the "used and useful" standard has meant in Pennsylvania and what Appellants understood it to mean when they prudently invested $50 million. In addressing the arguments of the Consumer Advocate and others that allowing recovery *of* the utilities' investment in the four CAPCO units would violate the "used and useful" standard, the PUC stated:

> What these parties purposefully overlook, however, is the fact that the used and useful standard controls the circumstances under which utility plant may be included in the rate base and thus earn a return *on* the investment in that utility plant. But even where investors are denied a return (earnings) on their investment in non-used and useful plant, the used and useful standard does not go so far as to sanction a taking of the investment itself.

[5]The *Philadelphia Electric* and *UGI-Luzerne* cases are particularly significant because they were decided contemporaneously with the decisions to begin the four CAPCO units. In June, 1972 an unforeseeable natural disaster known as Tropical Storm Agnes ravaged much of Eastern Pennsylvania. The PUC consistently allowed Pennsylvania utilities to amortize over 10 years their extraordinary losses caused by Tropical Storm Agnes. *See Pennsylvania Public Utility Comm'n v. Pennsylvania Gas & Water Co.*, 52 Pa. P.U.C. 525, 548-49 (1978); *Pennsylvania Public Utility Comm'n v. Philadelphia Electric Co.*, 48 Pa. P.U.C. 183, 202 (1974); *Pennsylvania Public Utility Comm'n v. Pennsylvania Gas & Water Co.*, 47 Pa. P.U.C. 750, 792 (1974); *Pennsylvania Public Utility Comm'n v. White Deer Mountain Water Co.*, 47 Pa. P.U.C. 530, 552 (1974); *Pennsylvania Public Utility Comm'n v. Bell Telephone Co. of Pennsylvania*, Pa. P.U.C. 247, 279-80 (1973).

Brief of Pennsylvania Public Utility Commission in the Supreme Court of Pennsylvania, p. 27 (hereinafter "PUC Pennsylvania Brief") (emphasis in original).[6]

The PUC goes on in its Pennsylvania Brief to cite an entire line of cases that applied the "used and useful" standard to deny a return *on*, but not *of* a utility's investment. PUC Pennsylvania Brief at 28-31. *See Philadelphia Electric Co. v. Pennsylvania Public Utility Comm'n*, 61 Pa. Cmwlth 325, 433 A.2d 620 (1981) (excluding from rate base a portion of a utility's generating plant that was excess capacity, but allowing recovery of operating expenses, including depreciation charges on the entire plant); *Pennsylvania Electric Co. v. Pennsylvania Public Utility Comm'n*, 509 Pa. 324, 502 A.2d 130 (1985), *appeal dismissed*, 476 U.S. 1137 (1986) (removing entire idle Three Mile Island (TMI) Unit No. 1 from rate base but permitting utility to recover its operating expenses related to the plant); *Pennsylvania Public Utility Comm'n v. Metropolitan Edison Co.*, 55 Pa. P.U.C. 428 (1982) (permitting amortization of costs associated with the damaged TMI Unit No. 2); *UGI Corp. v. Pennsylvania*

[6]This Court should generally disregard the positions taken by the PUC in its Brief in this Court. The PUC Pennsylvania Brief not only conceded, but argued, that Pennsylvania has historically differentiated between rate base (return *on*) and expenses (return *of*) in applying the "used and useful" test. PUC Pennsylvania Brief at 27-31. Further, the PUC argued that Act 335 is unconstitutional as applied to Appellants:

> [I]t would constitute an unconstitutional taking of public utility property (Duquesne's and Penn Power's share of the investment in the cancelled plants) to impose a public duty to commit the funds for a public purpose and then, after circumstances have changed causing the construction project to be cancelled, to deny Duquesne and Penn Power recovery of the funds prudently expended pursuant to its [sic] public duty.

Id. at 23. Perhaps as a result, the PUC's brief in this Court is confined exclusively to the issue of the constitutional right of utility investors to a return *on* their investment, an issue not directly presented on this record. Even in this Court, the PUC does not go so far as to suggest that the "used and useful" test has heretofore been applied in Pennsylvania to deny a return *of* a utility's investment.

Public Utility Comm'n, 49 Pa. Cmwlth. 69, 410 A.2d 923 (1980) (permitting amortization of terminated feasibility studies).

As the *Pennsylvania Electric* and *Metropolitan Edison* decisions show, Pennsylvania has permitted the utility owners of the Three Mile Island units, which of course were rendered not "used and useful" by the most serious nuclear incident in this country's history, to recover their out-of-pocket costs through amortization. The State, however, has retroactively and without warning refused to permit the same recovery to two utilities (and because of the bizarre interaction with the subsequently enacted 66 Pa.C.S. § 520, only these two utilities) that prudently cancelled their investments due to unforeseen and unforeseeable circumstances.

As a result of Pennsylvania's established regulatory scheme, Appellants reasonably expected that they would receive, at minimum, a recovery *of* their investment, even if unforeseeable circumstances rendered their investment not "used and useful." The concession by Appellees that the decision to commence work on the CAPCO units was prudent strongly confirms this conclusion, because it would have been wildly imprudent for Duquesne and Penn Power to embark upon the construction of four massive nuclear generating units without an expectation that they would *at least* ultimately see the return *of* the funds expended. By changing the rules of the game long after the investment in the four CAPCO units had been made, Act 335 has prevented Appellants from ever being compensated. This type of regulatory treatment is unfair and confiscatory.

3. A public utility is subject to a statutory duty to serve and is entitled to a return of prudent investments made in the performance of that duty. Appellees and supporting amici seek to apply to public utilities the

same legal standard for a "taking" that is applied to the regulation of non-utility businesses. Brief for Consumer Advocate at 34-39; Brief for National Governors' Assoc., et al., at 24-30; Brief for CFA, et al., at 4-41. These arguments ignore the unique role played by public utilities and the special duties and obligations imposed on them. Like many states, Pennsylvania has imposed on public utilities a statutory duty to serve. The relevant statute, 66 Pa.C.S. § 1501, provides:

> Every public utility shall furnish and maintain adequate, efficient, safe, and reasonable service and facilities, and shall make all such repairs, changes, alterations, substitutions, extensions, and improvements in or to such service and facilities as shall be necessary or proper for the accommodation, convenience, and safety of its patrons, employees, and the public. Such service also shall be reasonably continuous and without unreasonable interruptions or delay.

As a result of their statutory obligation to provide "adequate" and "reasonably continuous" service, public utilities, unlike other businesses, are required to assist the State in ensuring a reliable supply of electric power. The utility becomes, in effect, the State's agent. Justice Brandeis recognized this fundamental concept in declaring that a public utility "is the substitute for the state in the performance of the public service; thus becoming a public servant." *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Comm'n.* 262 U.S. 276, 291 (Brandeis, J. concurring).

Whereas states have been permitted generally to regulate non-utility businesses so as to "adjust [t]he benefits and burdens of economic life," *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124 (1978), states may not thrust utilities into the role of a public servant without some form of protection. *Cf. Id.* at 120 n. 21 & 121 n. 23. *Accord, id.* at 146 & n. 9 (Rehn-

quist, J. dissenting). Where a utility has acted prudently in investing in plant expansion for the benefit of its consumers, "[t]he compensation which the Constitution guarantees an opportunity to earn is the reasonable cost of conducting the business." *Southwestern Bell*, 262 U.S. at 291.

Pennsylvania's attempt to deny Appellants any recovery of their $50 million investment cannot be justified as a "sharing" of risks. Under the State's approach, the consumer who enjoys the benefits of the utility's statutory obligation to provide continuous electric service need not assume any of the risk for prudent investments in electric generating facilities that are subsequently determined not to be "needed." Whereas the prudent investment standard balances investor and consumer interests by preventing the investors from recovering a return *of* or *on* imprudent investments, the approach adopted by the Pennsylvania Supreme Court below arbitrarily assigns the *entire* risk of cancellation to the investors without compensating investors for that risk and without any finding of fault on the part of management. Act 335 thus is not a mechanism by which risks are "shared," but rather a manipulative mechanism for shifting risks in their entirety onto the investors.[7]

[7]Appellees and amici stress Judge Starr's criticism of the prudent investment standard as being pro-utility. Brief of Consumer Advocate at 44-45; Brief of IECPA, et al., at 15-17, 25; Brief of NARUC, at 18-19, 23. *See Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1190 (D.C. Cir. 1987) (Starr, J. concurring). These parties fail to acknowledge, however, that Judge Starr equally criticized the "used and useful" standard as being pro-consumer, even in a factual context where that standard was being applied, as it has been historically, solely to limit rate base and not to restrict recovery of prudent out-of-pocket expenses. Even in that context, Judge Starr said "the 'used and useful' rule, taken alone, is skewed heavily in favor of ratepayers. It also lacks balance." *See* 810 F.2d at 1191. While Appellants do not embrace all of Judge Starr's analysis, Act 335 plainly would not survive the constitutional test suggested by his concurrence:

> Thus it is that a taking occurs not when an investment is made (even one under legal obligation), but when the balance between investor

(Footnote continued on following page)

4. Duquesne and Penn Power undertook the investments at issue under statutory obligation and at the encouragement of the PUC. Appellees and supporting amici suggest that Appellants' decisions to invest in the four CAPCO units were entirely voluntary. *See* Brief for Consumer Advocate at 5; Brief for PUC at 19-20; Brief for IECPA, et al., at 7-8; Brief for CFA, et al., at 46-50.[8] Appellants volunteered in the same way an army private "volunteers" for a task "suggested" by his superior officer. Although the PUC's *Investigation of the Need for Additional Electric Generating and Transmission Facilities*, 46 Pa, P.U.C. 23 (1972), did not result in an order compelling Duquesne and Penn Power to build more capacity, the PUC's opinion in that *Investigation* details almost a decade's worth of PUC arm-twisting aimed at getting the utilities in the state to invest in more electric generating capacity. No one can seriously dispute that even as late as August 29, 1973, the PUC still perceived a "present emergency" concerning which

(Footnote continued from previous page)

> and ratepayer interests—the very function of utility regulation—is struck unjustly. Although the agency has broad latitude in striking the balance, the Constitution nonetheless requires that the end result reflect a reasonable balancing of the interests of investors and ratepayers. As we have seen, both investors and ratepayers were the intended beneficiaries of the Forked River investment; both should presumptively have to share in the loss.

810 F.2d at 1191.

[8]CFA also asserts that Appellants voluntarily assumed the risks associated with nuclear power plants and the building of "excessive" generation because the "electric industry debate" about capital expansion "had already begun." Brief for CFA, et al., at 49. Whether the law review articles cited constitute an "industry debate" is questionable. Further, this Court has recently observed that "[a]t the time construction of [the Grand Gulf nuclear power plant] was initiated [in April 1974], no one anticipated the enormous cost overruns that would be associated not only with that plant but also with virtually every nuclear power facility being constructed in the United States." *Mississippi Power & Light Co. v. Mississippi*, 108 S.Ct. 2428, 2436, n.9 (1988).

the PUC "*insisted* that construction be accelerated. . . ." *Pennsylvania Public Utility Comm'n v. Metropolitan Edison Co.*, 47 Pa. P.U.C. 56, 59 (1973) (emphasis added). As the PUC itself acknowledged in the court below, the PUC's view was that Appellants had "the duty to plan and construct new power plants." PUC Pennsylvania Brief at 22-23. Given the utilities' statutory obligation to provide service, as well as the PUC's role in regulating their rates, the utilities would have been imprudent in the extreme if they had not responded to the urgings of the PUC.

5. State action, and not market forces, has prevented the utilities from recovering their investment. Appellees and supporting amici rely on *Market Street Railway Co. v. Railroad Comm'n*, 324 U.S. 548 (1948), for the proposition that a utility cannot constitutionally challenge a rate order where "market forces" have caused the taking. *See* Brief for Consumer Advocate at 23-24; Brief for PUC at 36-38; Brief for National Governors Assoc., et al., at 18,22; Brief for CFA, et al., at 40,46; Brief for NASUCA at 40-42; Brief for IECPA, et al., at 18. *Market Street Railway* is not applicable to this case. It is true that market forces, in the form of an unforeseeable failure of electric demand, triggered the prudent decision to cancel the four CAPCO units. But it is not market forces that are preventing Appellants from collecting the rates they seek here. The street railway in *Market Street Railway* was unable to earn sufficient revenue to cover its costs, not because the rate order prescribed rates that were too low, and not because it was denied a return *of* or *on* any of its prudent investment, but rather because the railway simply was unable to compete with other modes of transportation. It was unable to attract enough fare-paying riders to cover its expenses. The present case is unlike *Market Street Railway*. Appellees

and supporting amici concede that, although the amounts at issue are measured in the tens of millions of dollars, these amounts represent only a small fraction of the rates involved, and thus clearly could be absorbed by the market.[9] The utilities' inability to recover their expenses in this case is the result of the State's refusal to include these costs in rates and not competition or market forces.

6. The investors in Duquesne and Penn Power have not otherwise been compensated in rates. Appellees and supporting amici have argued that providing a return *of* investment results in double counting where a larger than normal return *on* the investment has been allowed in anticipation of adverse conditions. *See, e.g.*, Brief for CFA, et al., at 53.[10] That consideration cannot save Pennsylvania's method of fixing rates. Appellees and supporting amici themselves assert that the effect of Act 335 and other unspecified Pennsylvania ratemaking legislation is to prohibit recovery of prudent uncompleted plant expenses either in rate base or "otherwise . . . in the rates charged," thus precluding recovery as a surcharge added to the rate of return.

The rates of return fixed by the PUC in this case for Duquesne and Penn Power have been set on the as-

[9] *See* Brief for Consumer Advocate at 12; Brief for PUC at 35; Brief for IECPA, et al., at 20. Amici Consumer Federation of America, et al., argue that the test should be the ability of Appellants to recover their cancellation costs in a hypothetical free market, and that Appellants cannot meet that test because other competitors will not have unforeseeable prudent investment losses, and will therefore set the industry price level too low to permit Appellants to retrieve their cancellation costs. Brief for CFA, et al., at 52-53. In addition to its lack of record support, a hypothetical free market approach would complicate an already complex regulatory process with a layer of unnecessary economic speculation.

[10] *See e.g., Washington Gas Light Co. v. Baker*, 188 F.2d 11, 19-20 (D.C. Cir. 1950), *cert. denied*, 340 U.S. 952 (1951); *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168 (D.C. Cir. 1987) (Mikva, J. dissenting).

sumption that the cancellation costs associated with the four CAPCO units would be recovered by amortization *of* those costs. The PUC, intimately familiar with its own past practices and mindful of its constitutional obligations,[11] necessarily recognized that there was no need to adjust the utilities' rates of return to compensate investors for the risk of losing their out-of-pocket investment due to unforeseeable circumstances, since it had ordered that the utilities be compensated directly through amortization. Act 335 denies the investors of Duquesne and Penn Power this just compensation.

The utilities cannot be expected to have received their compensation by operation of the market. If the risk is not foreseeable, the market will not include the risk in the utility's or the industry's price-earning ratios or other financial indicators, and the risk, therefore, will not be included in the utility's return on equity. Pennsylvania's method of ratemaking, moreover, guarantees that the utilities will not be compensated by higher returns in the future. Because investors will always be restricted to a modest return on the historical value of their original investment, a capital loss created by unforeseeable detrimental conditions will not be restored by the gains from unforeseeable beneficial conditions or from efficient utility management. In short, the utility is unable to use the profits from its "Mustangs" to restore the losses from its "Edsels." This unrecovered con-

[11] *See, e.g.*, note 5, *supra*, and accompanying text. The PUC not only conceded, but argued below that:

> [A]lthough the Commission may deny rate base recognition and thus a return *on* the investment in cancelled power plants, it would constitute a violation of the Fifth and Fourteenth Amendments to the United States Constitution to deny the electric utilities recovery *of* the costs prudently invested and incurred.

PUC Pennsylvania Brief at 22 (emphasis in original).

sumption of investment mandated by state action is inherently unfair and confiscatory.

7. The investment in the four CAPCO units was not a "failed" investment. The attempts of Appellees and supporting amici throughout their briefs to characterize the investments at issue as "failures" or "mistakes," and their assault upon the prudent investment test generally, are nothing more than an attempt to subvert the factual finding of prudence on this record. Nothing in the record supports any inference that the expenditures on the CAPCO units were "excessive", "wasteful" or motivated by anything other than the utilities' statutory duty to ensure a continuous supply of electricity. The prudently incurred costs involved in this case were "failed" costs (or costs carrying similar implications of misfortune, imprudence or lack of utility) only in the sense that fire insurance costs are "failed" costs because no fire occurred during the policy period. Appellants' ratepayers obtained the security of having sufficient electric energy potentially available to meet the then-consensus predictions of need. As a matter of "justness and fairness," *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 607, (1942) (Black, J. concurring). they should at least share in the associated costs.

CONCLUSION

For these reasons, as well as the reasons set forth in Appellants' opening brief, the judgment of the Supreme Court of Pennsylvania should be reversed and the rate orders of the PUC reinstated.

Respectfully submitted,

ALAN L. REED
WILLIAM E. ZEITER*
PETER BUSCEMI
JOHN F. STILLMUN, III

MORGAN, LEWIS & BOCKIUS
2000 One Logan Square
Philadelphia, PA 19103
(215) 963-5367

CHRISTINE A. HANSEN
RICHARD S. CHRISTNER
LARRY R. CRAYNE
DUQUESNE LIGHT COMPANY
1 Oxford Centre
301 Grant Street
Pittsburgh, PA 15279

JAMES R. EDGERLY
STEPHEN L. FELD
PENNSYLVANIA POWER COMPANY
1 East Washington Street
New Castle, PA 16103-0891

Attorneys for Duquesne Light Company and Pennsylvania Power Company

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*Counsel of Record